IN THE

Supreme Court of the United States

October Term, 1942

Nos. 893-894

GEORGE E. EDDY and SAMUEL SILBIGER,

Petitioners,

—against—

CHARLES H. KELBY and CLIFFORD S. KELSEY, Trustees of The Debtor, PRUDENCE BONDS CORPORATION (New Corporation), RECONSTRUCTION FINANCE CORPORATION, *et al.*

Respondents.

REPLY BRIEF ON BEHALF OF PETITIONERS

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The Goldner Press—New York City

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I.

As to Respondents' contention that an appeal from the order on allowances could only be had in the discretion of the Circuit Court.

Respondents erroneously assume the premise that the allowances made herein were for services rendered in a corporate reorganization proceeding and then cite *Dickinson Industrial Site, Inc.*, 309 U. S. 382, as authority to support their contention, that an appeal from the order on such allowances is permissible only in the discretion of the Circuit Court. There is no dispute as to the applicability of the *Dickinson* case to awards of allowances for services rendered in a reorganization proceeding, but petitioners

contend that in the instant case the services rewarded were rendered in controversies supplemental to and growing out of the reorganization proceeding and the jurisdiction of the District Court over the accounting proceedings was complementary to the confirmed plan and auxiliary to it.

The facts in *re Von Kozlow Realty Co.*, 116 F. 2d 673, *In re Country Club Bldg. Corp.*, 128 F. 2d 36, and *In re Prudence-Bonds Corporation*, 111 F. 2d 37, 41, all disclose that the services rendered were *in the reorganization proceedings* and are not germane to the issues in the case at bar.

In *re Von Kozlow Realty Co., supra*, the appeal arose out of applications for trustees', attorneys', engineers' and other parties' fees and expenses allowed by the Court in connection with the attempted corporate reorganization under Section 77B of the Bankruptcy Act. There never was any reorganization and the petition was dismissed because of the inability to obtain the necessary consents to the plan. Thereafter, through foreclosure in the State Court the realty constituting the only asset of the debtor was conveyed to appellee, holder of a lien. The fees for services in the reorganization were allowed subject to the rights of the appellee. Payment was apparently made junior to the appellee's interest. Appellee moved to dismiss the appeal on the ground that leave to appeal had not been obtained. The Court said: "Clearly if the appeal is from an order making or refusing allowances *in a reorganization proceeding*, under the Chandler Act application must be made to this Court for the allowance of the appeal."

Obviously, the services in that case were rendered in connection with the proposed plan and prior to the confirmation or rejection of the plan and came definitely within the express provision of Section 243 of the Chandler Act which provides:

> "* * * In fixing any such allowances, the judge shall give consideration only to the services which contributed to the plan confirmed or to the refusal of confirmation of a plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental thereto."

The allowances involved in *re Prudence-Bonds Corporation, supra,* were likewise for services in the bankruptcy reorganization proceeding—while the debtor's estate was in the custody of the bankruptcy court and title thereto was in the debtor's trustees from the filing of the petition in 1934 up to the time the plan was confirmed, and the Court surrendered its custody in 1938, and the debtor's trustees transferred all their title to the estate pursuant to the order of the Court. Those were the allowances made in the orders for services concededly rendered in the reorganization proceeding and referred to in paragraph 4, page 110 of the record.

In lieu of meeting squarely the issues in this case respondents attempt to becloud the issues by quoting, on page 8 of their brief, an excerpt from the brief submitted by petitioners to support the complete jurisdiction of the District Court over the accounting filed by the trustees, and disparagingly suggest that such excerpt (dissociated from the context of the brief), represents petitioners' real views as to the status of the reorganization trustees and that such views are inconsistent with their contentions now advanced by them. Such is not the case—and the supposed inconsistency can exist only in the minds of respondents because they ignore the change in the status of the debtor's trustees wrought by the confirmation of the plan of reorganization and the transfer by the debtor's trustees of all their title in the estate to the New Corporation pursuant to the plan of reorganizaion.

Petitioners do not dispute but reassert and now claim that upon the filing of debtor's petition for reorganization, its approval by the Court and the appointment and qualification of the trustees of the debtor, the title to the claims of the bondholders, predicated on the mismanagement and improper diversion of the trust funds or *res* vested in the debtor's trustees as assets of the bankruptcy estate, and the right of action to enforce such claims and recover the diverted funds accrued to and vested solely in the reorganization trustees. But that was in June, 1934.

From 1934 and until the confirmation of the plan of reorganization in 1938, the debtor's trustees could have instituted the necessary legal proceedings to enforce the bondholders' rights as a part of marshalling the assets of the debtor's estate—but failed to do so. Likewise the bondholders could have reorganized such claims, as part of the plan; but they did not. The plan did not alter or modify such claims and they were specifically preserved (R. 9, 111, 112).

Also, pursuant to the plan of reorganization and the order of the Court the debtor's trustees transferred and assigned all their rights in and to the collateral securing the eighteen series of bonds to the New Corporation (R. 3, 112).

Obviously therefore, whatever it may ultimately be decided was the devolution of the title or rights to the claims of the bondholders as against the corporate trustees under the original trust indentures—it is indisputable that such temporary title was divested from, and is NOT now in the debtor's trustees.

Respondents further misconceive the issues by disputing the analogy between the confirmation of a plan of reorganization and the confirmation of composition, and assert that the latter operates as a discharge whereas the former effects a discharge only upon final decree. Just what bearing the discharge of the debtor has upon the question of whether

the debtor's trustees became strangers to the trust funds after the confirmation of the plans and the transfer of the estate out of the custody of the bankruptcy court to the substituted trustee pursuant to the plan so as to entitle the debtor's trustees to prosecute the bondholders' claims against the superseded corporate trustees, petitioners cannot conceive. The right to assert and prosecute such claims depends entirely on who holds the title thereto—and as pointed out above—the one uncontroverted fact in the case at bar is that such title is not in the debtor's trustees.

In all prior appeals, *Central Hanover Bank & Trust Co.* v. *Bank of Manhattan,* 105 F. 2d 130, *Manufacturers' Trust Co.* v. *Kelby,* 125 F. 2d 650, and *Brooklyn Trust Co.* v. *Kelby,* 134 F. 2d 105, the Circuit Court decided that the restoration actions by bondholders were part of the trust funds or res. Such trust funds, which prior to the confirmation of the plans were in the custody of the reorganization Court were by that Court's order transferred and assigned to the successor trustee and the title to such claims of the bondholders vested in the successor trustee.*

No asset, tangible or intangible remained in the Court's control as a bankruptcy res and consequently no bankruptcy estate remained for administration. *In re Paramount-Publix Corp.,* 82 F. 2d 230 is therefore inapposite.

In *Reconstruction Finance Corp.* v. *Bankers Trust Company,* decided February 8th, 1943 U. S. , 87 L. Ed. 481, 63 S. Ct. 515, the services compensated were rendered and incurred "in connection with the proceedings and plan" and the Court held Sec. 77, Sub. c (12) applicable and it has no bearing in the instant case.

In *Gross* v. *Bush Terminal Co.,* 105 F. 2d 930, the fees and allowances that were awarded were for services that

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* The right of the bondholders to object to the accounts was a derivative right which accrued to them as beneficiaries because the modified trust indenture absolved the substituted trustee from such duty.

were a "contribution to the plan" and the question of a right to or procedure for an appeal was not presented.

Gross v. *Irving Trust Co.*, 289 U. S. 342, involved a question of the right of the State Court to fix fees of its receiver and counsel after the supervention of bankruptcy and the vesting of the title to bankrupt's property in the trustee in bankruptcy. The Court held the bankruptcy court had exclusive jurisdiction to fix the compensation and granted a summary turn over order.

In the Matter of B. H. Inness Brown, N. Y. , not officially reported, Law Report News, April 27, 1943, the services were rendered in the State Court as a step to marshal assets of the bankruptcy estate. The decision was by a divided Court, 4 to 3, but seems in harmony with the contention that the services were in a bankruptcy *proceeding, i.e.,* conducted in the State Court pursuant to the direction and authority of the bankruptcy court.

All these cases cited and relied on by respondents had one common factual prerequisite which was the very basis of the decisions. In each case there was a "bankruptcy estate" in the control of the Court, title to which was in the trustee in bankruptcy, which was being administered by the bankruptcy court, and out of which the fees and allowances awarded were to be paid. See *Sherman* v. *Buckley,* 119 F. 2d 280, cert. denied 314 U. S. 657. *Per contra,* in the case at bar, the accounting proceeding was not a bankruptcy administration—but the administration by a Court of Equity of a continuing voluntary *inter vivos* trust. The fund realized by the services rendered was not a fund, to which a bankruptcy trustee had title but one in which the title was held by a trustee under the terms of the trust indenture. The litigation in which the services were rendered was not between a "bankruptcy trustee" and adverse claimants, but between the superseded trustee of the voluntary express trust and the beneficiaries of the trust.

It involved no rights or claims to any part of a bankruptcy estate—but the rights of the beneficiaries of the trust to a specific performance of the trust and the restoration to the trust funds of property and cash improperly diverted therefrom. The money and property recovered, were not paid to a "bankruptcy trustee," but into the trust funds securing the bonds and to the successor trustee under the trust indenture.

The Bankruptcy Act is replete with proof that Congress recognized the inherent difference between a bankruptcy proceeding and controversies arising in or out of bankruptcy. Section 23 confers on the District Courts jurisdiction "of all *controversies* at law or in equity, as distinguished from *proceedings* under this Act * * *" Section 24 confers appellate jurisdiction on the Circuit Court "in *proceedings* in bankruptcy * * * and in *controversies* arising in bankruptcy. * * *" This Court has consistently recognized such distinction where the bankruptcy court and the State Court had concurrent jurisdiction of a controversy. *Schoenthal* v. *Irving Trust Co.*, 287 U. S. 92; *Taylor* v. *Voss*, 271 U. S. 176; *Collett* v. *Adams*, 249 U. S. 545.

Section 241 of Chapter X *et sequi* only confer jurisdiction on the district judge to "allow reimbursement for proper costs and expenses * * * incurred in a *proceeding* under this Chapter." Obviously therefore the limitation on the right to appeal from allowances of compensation contained in Section 250 was intended by Congress to apply only to such allowances as were fixed and made under the specific authority of Section 241—*i.e.*, in a "*proceeding* under this Chapter" and can have no application to allowances for services rendered in a *controversy* between a superseded trustee of an express trust and the beneficiaries of the trust involving the enforcement of the rights of the beneficiaries of the trust, which rights by the plan of reorganization were retained by the bondholders—and revested in the bond-

holders upon the confirmation of the plan before the accounting petitions were filed.

II.

As to the District Court's post-reorganization jurisdiction.

The question of the jurisdiction of the District Court over the accounting actions below is not an issue in this case. Respondents, however, have quoted copiously from the opinion of the Circuit Court in *Brooklyn Trust Company* v. *Kelby,* 134 F. 2d 105,* to prove such jurisdiction—which has never been attacked or disputed by any party to the instant proceeding. That case advanced and discussed various theories upon which the lower Court had the jurisdiction and the power to pass upon and settle the accounts of the superseded corporate trustees, but it had no occasion to, nor did it attempt to pass upon the issues now presented to this Court. In that case the question involved was whether the District Court, having taken jurisdiction over the corporate trustee's account as superseded trustee of the 5th Series bond issue of the debtor, had the power and properly exercised the power to enjoin an action in the State Court brought by Brooklyn Trust Company as a testamentary trustee, a former bondholder, against said superseded trustee, based upon alleged violations of its trust duties.

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* Brooklyn Trust Company, on May 6th, 1943, filed its petition for a writ of certiorari, and served same on the petitioners herein on May 7th, 1943; petitioners herein as respondents in the Brooklyn Trust Company case will file their brief in opposition to said writ on or before May 27th, 1943. The motive of respondents herein, in referring to the Brooklyn Trust Company case probably was to integrate that petition for a writ with the instant petitions for writs in the minds of this Court so that they may be considered and passed on at one and the same time.

The question of the basis of the Court's jurisdiction over the accounting proceedings is not important in this case. It is conceivable that an accounting by a trustee of an express trust may be laid in the Federal Court based on diversity of citizenship, or as in the case at bar, because the accounting was incidental to the power of the Court, pursuant to a confirmed plan of reorganization to supersede the trustee and substitute a new trustee, or because as suggested by the Circuit Court the superseded trustee consented to the jurisdiction of the District Court; or possibly it may be based on the inherent flexible power of a Court of Equity to administer justice to meet the particular situation presented. Regardless of what may be considered and determined to be the basis of the Court's jurisdiction what is of greatest moment is the extent of such jurisdiction and power in a determination of the law applicable to the rights of the parties litigant.

The Circuit Court on three occasions in connection with the accounting proceedings has ruled that such rights must be measured by the laws of New York State, *Central Hanover Bank & Trust Co.* v. *Bank of Manhattan Co.*, 105 F. 2d 130; *Manufacturers Trust Co.* v. *Kelby*, 125 F. 2d 650, cert. denied 316 U. S. 697; *Brooklyn Trust Co.* v. *Kelby*, 134 F. 2d 105 (certiorari pending). These decisions were in conformity with the ruling of this Court in *Erie* v. *Tompkins*, 304 U. S. 64.

In the case at bar the District Court did not measure the rights of petitioners and respondents as if the accounting proceedings were litigated in the Court of New York State, and the Circuit Court has without opinion, improperly denied to petitioners the right of review which would have been available to them in the Courts of New York State.

After the confirmation of a plan of reorganization and final decree closing the estate the bankruptcy Court's jurisdiction terminates, except only as jurisdiction is necessary

to protect the Court's decrees or it has been specifically retained by the provisions of the plan or the order confirming the plan. A general reservation of jurisdiction in the order of confirmation is ineffectual to extend or continue the *bankruptcy* jurisdiction of the Court. As was said in *Re Flatbush Ave. Nevins St. Corp.*, 133 F. 2d 766 (C. C. A. 2):

> "Congress did not intend that the Bankruptcy Court should after approval of a plan under Chapter X * * * have power to remain a wet-nurse to the reorganized company. A bankruptcy court cannot obtain that power merely by inserting a provision reserving jurisdiction."

The jurisdiction of the District Court in the case at bar to take and judicially settle the accounts of the superseded trustees stemmed from the provisions of the plan of reorganization and the order confirming the same and not from any general jurisdiction under the Bankruptcy Statute. The exercise of such jurisdiction is complementary or auxiliary to the confirmation of the plan.

In *Clinton Trust Co.* v. *John H. Elliott Leather Co.*, 132 F. 2d 299 (C. C. A. 2), in respect to the question of post reorganization jurisdiction the Court said:

> "Quite consistently with this view, and as explained by several text writers, the reorganization court, as in the old equity receivership, may well be permitted to retain jurisdiction to protect its decree, prevent interference with the execution of the plan, and otherwise aid in its operation. * * * But this is a jurisdiction at most 'complementary' to that of confirming the plan and in reality only auxiliary to it. * * * It is not one for control of the corporation indefinitely or for keeping it in tutelage to the court, so that the latter must pass upon its business activities. * * *"

Under the circumstance then, in the instant case, the substantive rights of the parties must be construed by the Court as such rights were fixed by the provision of the plan—in accordance with state laws—precisely as if the Court were construing a contract or agreement, and as the plan preserved the rights of the bondholders as against the superseded trustees, in the enforcement of such rights the bondholders can be placed in no better or worse position than they would be in if such rights were being enforced in the State Court.

True, in the case at bar, there has been no final order closing the estate; nor has any order been entered discharging the debtor. However, an order discharging the debtor, it having been adjudged insolvent, and a new corporation of the same name having replaced it, would be but a meaningless gesture and can concern no one. The plan was consummated by the creation of the new corporation, the transfer of the trust funds to the successor trustees, the execution of the modified trust indenture and the transfer of all the property and rights of the debtor (which were temporarily vested in the debtor's trustees) to the new corporation. The new corporation and the successor trustee have been functioning under the plan for over five years, and as the rights of the bondholders against the superseded trustees were not affected by the plan, in the ascertainment and determination of such rights the final order closing the estate in bankruptcy can have no pertinence.

Dated, May 19th, 1943.

Respectfully submitted,

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